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HEADLINE: Creating Coverage by Estoppel

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BODY:
IN 1959, Insurance Law @ 167(8) (now @ 3420) was enacted and an insurance carrier's ability to rely upon a policy exclusion to disclaim coverage was dramatically altered. Before the enactment of the statute, an insured was forced to rely upon the theories of common law waiver or estoppel to prevent the carrier from asserting policy defenses. Those theories required a showing that the insurer had either "waived" its right to rely on a policy exclusion or breach of a policy condition or had been estopped from doing so because the insured had been prejudiced by the carrier's delay in issuing a disclaimer.

In fact, this showing remains a prerequisite for those situations where Insurance Law @ 3420 is not applicable. n1 However, the scales tipped significantly in the insured's favor with the enactment of Insurance Law @ 3420. An insurer may be prohibited from disclaiming coverage based upon an otherwise valid policy exclusion, as a result of the unexplained passage of a period of time that a judge or jury finds unreasonable. An insured no longer need establish prejudice.

n1 Insurance Law @ 3420 applies to accidents in New York involving bodily injury or death.

Insurance Law @ 3420 imposes certain statutory requirements on a carrier that attempts to disclaim, and thus, the carrier's failure to comply with the strictly construed mandates of the statute is deemed by the courts to be "waiver"; that is, an intentional relinquishment of a right. Historically, however, before the enactment of the statute, the courts recognized the concept of estoppel to prevent an insurer from relying on policy exclusions where the insurer's actions were inconsistent with its later claim that there existed no coverage and the insured was thereby prejudiced. n2

n2 For example in 1929, the Court of Appeals in *Gerka v. Fidelity and Casualty Company* found the carrier estopped from disclaiming after it proceeded with the defense of a negligence action with knowledge of a claimed defense under the policy. 293 NY 119 (1944). In 1944, the Court of Appeals in *William M. Moore Constr. Co., Inc. v. USF&G,* held that the carrier was equitably estopped from denying coverage where the carrier assigned defense counsel and failed to advise its insured of a cross complaint by a co-defendant and entry of a judgment See also Albert Schiff v. Flack, 51 N.Y.2d 692 (1980); *O'Dowd v. American Surety Company of New York,* 3 N.Y.2d 374 (1957).

Beginning, most notably, with the enactment of Insurance Law @ 3420, the law regarding an insurer's ability to deny coverage has continued to be eroded by decisional law. While many

decisions have approvingly echoed the principle that "coverage will not be created where none exists," n3 the courts have carved an exception to this adage by recognizing the doctrine of "coverage by estoppel" or "equitable estoppel" in the context of the private contractual obligation between an insurance carrier and its insured.

n3 *Zappone v. Home Insurance Co.*, 55 NY2d 131 (1982); *Albert J. Schiff Associates v. Flack*, 51 NY2d 692 (1980).

Where the courts apply the doctrine of "coverage by estoppel," a coverage obligation is created despite the fact that the insurer would have owed neither defense nor indemnity, were it not for its affirmative actions upon which the insured has relied to his or her detriment.

In essence, the nullification of a disclaimer based upon the insurer's noncompliance with Insurance Law @ 3420 may afford an insured with coverage for an event not contemplated by the parties or encompassed by the premium paid. The situation can arise when there was a policy in effect on the date of the loss which would have afforded coverage to the insured, but for an applicable exclusion. In contrast, "coverage by estoppel" involves the actual creation of a policy obligation where there was no policy in effect on the date of loss or where the claim is outside the scope of the insuring agreement.

Fact Patterns

To aid in understanding the distinction between the different yet interrelated concepts of waiver and estoppel, consider the following scenarios. John Doe receives a summons and complaint naming him as a defendant in a personal injury case involving the operation of a motor vehicle. Doe sends a Notice of Loss to his automobile liability carrier. Assume that the insurer issues a timely disclaimer based upon the insured's use of the covered automobile in the scope of his employment, a specifically delineated exclusion under the policy. This exclusion is the only one cited in the disclaimer, despite the existence of other valid exclusions or conditions which have not been complied with by the insured.

Ultimately, and after several months, it is determined that the insured was not using the vehicle within the scope of his employment. However, the insured had also provided untimely notice of the claim in violation of policy conditions, a fact readily apparent to the carrier upon its receipt of the initial notice of loss. Based upon the insurer's failure to identify the insured's breach of the policy condition requiring timely in its initial disclaimer, the insurer is deemed to have "waived" its right to rely upon that policy condition.

Now, consider a factual situation, involving an occurrence-based policy, where there exist no apparent policy exclusions, but the policy period commenced one year after the date of the accident. However, upon receipt of the notice of claim, XYZ Insurance Company opens a claims file and assigns defense counsel. Defense counsel appointed by the carrier defends the case for one year. The claims representative at XYZ Insurance Company suddenly realizes, after a year of controlling the insured's defense, that the policy incepted after the date of loss. In that circumstance, some courts have estopped the insurer from denying that it owes defense or indemnity, relying upon the insurance carrier's control of the insured's defense for a significant period of time which has resulted in prejudice to the insured.

Courts that have recognized the principle of coverage by estoppel have held that estoppel will apply only where the insured can establish prejudice. However, prejudice has been implied where the insurer has exercised complete control of its insured's defense. See *Touchette Corp. v. Merchants Mutual Insurance Company;* n4 *Globe Indemnity Company v. Franklin Paving Company;* n5 *Corcoran v. Abbott Sommers, Inc.;* n6 *Sedgwick Avenue Associates v.*

Insurance Company of the State of Pennsylvania; n7 *National Indemnity Co. v. Ryder Truck Rental,* n8 where the Second Department held that the issue of whether a carrier should be estopped is a question of fact to be determined by a jury. See also, *Hartford Insurance Group v. Mello,* n9 where the Second Department held that the insurer, who had defended the action for two years before the institution of the declaratory judgment action, was estopped from disclaiming coverage. "A disclaimer two years after knowledge of noncoverage, during which time Hartford had assumed the complete defense of the defamation action, and after the underlying action had been placed on the trial calendar, cannot be considered timely and is prejudicial as a matter of law."

n4 76 AD2d 7, 429 NYS2d 952 (4th Dept. 1980).

n5 77 AD2d 581, 430 NYS2d 109 (2nd Dept. 1980).

n6 143 AD2d 874, 533 NYS2d 511 (2nd Dept. 1988).

n7 203 AD2d 93, 610 NYS2d 39 (1st Dept.1994).

n8 230 AD2d 720, 646 NYS2d 169 (2nd Dept. 1996).

n9 81 A.D.2d 577, 437 N.Y.S.2d 433 (2nd Dept. 1981).

Contrary Holdings

While the exercise of control over the insured's defense is significant, the courts have not applied coverage by estoppel in every instance where the insurer has appointed defense counsel. For example, in *Nassau Insurance Company v. Manzione*, n10 even though the carrier had assigned defense counsel who answered the complaint and demanded a verified bill of particulars, the court did not estop the carrier from disclaiming coverage 13 days later.

n10 112 AD2d 408, 492 NYS2d 66 (2nd Dept. 1985).

In *Manzione*, the policy period commenced approximately one week after the date of loss and, in its decision, the court distinguished between a policy exclusion and a situation where no policy was in effect. The court did not discuss the existence or lack of prejudice to the insured. In *Hartford Accident & Indemnity v. Carson C. Peck Memorial Hospital,* n11 where there was also no policy in effect on the date of loss, the court found no prejudice by the continued defense provided by the carrier.

n11 162 AD2d 659, 558 NYS2d 959 (2nd Dept. 1990).

Similarly, the Second Department refused to create coverage by estoppel in *Van Buren v. Employers Insurance of Wausau* n12 even though the carrier provided the insured with a defense for a year before disclaiming on the ground that the dates of loss were outside its policy period. This holding was followed by the Fourth Department in *Tantillo v. USF&G.* n13

n12 98 AD2d 774, 469 NYS2d 488 (2nd Dept. 1983).

n13 155 AD2d 970, 547 NYS2d 781 (4th Dept. 1989).

In *Indemnity Insurance Company of North America v. Charter Oak Insurance Company* n14 the court held that INA was obligated to afford defense and indemnity to the insured even though the accident occurred outside of Indemnity's coverage period. In the *INA* case, the carrier assumed the defense of its insured, but failed to notice that the personal injury occurred prior to the effective date of its policy.

n14 235 AD2d 521, 653 NYS2d 135 (2nd Dept. 1997).

INA requested that the insured assign its own defense counsel. However, the insured refused. INA had defended its insured in the underlying action for more than three years before commencing the declaratory judgment action. The lower court specifically declined to follow the Fourth Department holding in *Tantillo*.

The Supreme Court decision in *INA* distinguished *Van Buren and Nassau Insurance Co.* by commenting that, in "Nassau Insurance Co., the non-covering insurer demanded that the covering insurer assume the defense within three weeks after service of the complaint and in *Van Buren* the court clearly held that such a demand was made within a reasonable time, defeating any claim of prejudice necessary for the application of equitable estoppel."

Most recently, the court applied this principle in *Martini v. Lafayette Studios Corp*. n15 In *Martini,* a Supreme Court, New York County Judge held that Atlantic Mutual Insurance Company was obligated to defend and indemnify its insured despite the expiration of its policy before the loss.

n15 177 Misc.2d 383, 676 NYS2d 808 (N.Y. Sup. 1998).

Atlantic had initially advised the insured that it would provide a defense and had referred the matter to defense counsel. It was not until more than one year later that Atlantic advised the insured that it would not provide defense or indemnity as the claim incepted after the policy had expired.

The court, finding that the insured had been prejudiced, held that Atlantic was estopped from denying coverage. The court opined that the insured was "lulled . . . into not being concerned about the need for any other coverage" and thus did not notify the proper carrier "as soon as practicable."

In another recent decision, this from the Supreme Court, Tompkins County, the court held that an insurer was estopped from denying coverage where it had knowledge that the insured was convicted of assault in the second degree, a crime requiring a showing of intent, and yet the insurer continued to provide a defense for an additional three years. "The criminal conviction should have moved the insurer to assess the new situation and to disclose its conclusions to the putative insured and injured party," the court found.

The court further noted that the insurer should have known that its interests and those of its insured had diverged, since the insured had been convicted of a crime requiring a showing of intent, and thus there was no occurrence which would trigger an indemnity obligation under the policy. *Travelers v. Wiener*. n16

n16 666 NYS2d 392 (Sup. Ct. 1997).

Conclusion

Under the current state of the law, an insured has the burden of establishing that he or she has been prejudiced as a result of the action or inaction of the insurer in order for the court to apply the doctrine of "coverage by estoppel." A court is less likely to find the insured's rights have been prejudiced where the insurer has issued a reservation of rights and has offered to allow the insured's private counsel to participate fully in the defense of the action.

Furthermore, the lengthier the delay in denying that a coverage obligation exists after the insurer determines that the claim is outside the scope of coverage of the policy, the greater the likelihood that the principle of coverage by estoppel will be applied. Because of the court's recognition of "coverage by estoppel," a carrier must be concerned, not only about issuing a timely and proper disclaimer based upon an exclusion contained within the policy, but also upon confirming the existence of coverage in the first instance before offering the claimed insured a defense. The insurer must also be concerned about denying a claim promptly once facts are known which bring a claim outside the scope of coverage of the policy.